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This memorandum is supplemental to our memorandum of  
May 7, 1991, which discussed issues raised under section 956  
of the Internal Revenue Code with respect to [REDACTED]

FACTS:

For convenience, we have restated the facts of this  
case. On [REDACTED], a domestic corporation, purchased  
all of the stock of [REDACTED], a  
publicly traded U.K. corporation. [REDACTED] made a section 338  
election with respect to this purchase and selected  
[REDACTED] as the deemed acquisition date for  
purposes of this election.<sup>1</sup> At the time of this  
acquisition, [REDACTED] owned all of the stock of [REDACTED],  
a U.K. corporation,  
which owned all of the stock of [REDACTED], a domestic corporation. In  
[REDACTED], direct ownership of [REDACTED] was shifted from  
[REDACTED] to [REDACTED] pursuant to a plan of reorganization.

<sup>1</sup> Section 224(d) of the Tax Equity and Fiscal  
Responsibility Act of 1982, as amended by section 306(a)(8)(B)(i)  
of the Technical Corrections Act of 1982, provided guidelines  
under which a purchasing agent could select a date that would be  
treated as the acquisition date for purposes of making a section  
338 election under the transitional rules of section 224(d)(2).

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When [REDACTED] acquired the stock in [REDACTED] directly and indirectly held two obligations of [REDACTED] on which the total outstanding balance was \$ [REDACTED]. The first obligation was acquired on [REDACTED] when [REDACTED] lent [REDACTED] the principal amount of \$ [REDACTED]. The second obligation was acquired on [REDACTED] when [REDACTED] a wholly-owned subsidiary of [REDACTED] lent [REDACTED] the principal amount of \$ [REDACTED]. [REDACTED] transferred this receivable to [REDACTED] on [REDACTED] in satisfaction of other obligations due [REDACTED] by [REDACTED].

ISSUE:

Does [REDACTED]'s election under section 338(g) of the Code with respect to [REDACTED] affect whether the [REDACTED] obligations that [REDACTED] held are "United States property" within the meaning of section 956(b) of the Code?

LAW & ANALYSIS:

Section 956(b)(2)(F) excludes from the definition of United States property, the stock or obligations of a domestic corporation which is neither a U.S. shareholder of the controlled foreign corporation (CFC), nor a domestic corporation, 25% or more of the total combined voting power of which, immediately after the acquisition of any stock in such domestic corporation by the CFC, is owned, or considered as being owned by such U.S. shareholders in the aggregate.

Section 1.956-2(b)(1)(viii) of the regulations, provides that the stock or obligations of an unrelated corporation will be excluded from the definition of United States property. An unrelated corporation is a domestic corporation that is neither a United States shareholder of the CFC making the investment, nor a corporation 25 percent or more of whose total combined voting power is owned or considered as owned (within in the meaning of section 958(b)) by United States shareholders of the CFC making the investment. Section 1.956-2(b)(1)(viii). The determination of whether a domestic corporation is an unrelated corporation is made immediately after each acquisition of stock or obligations by the controlled foreign corporation. Section 1.956-2(b)(1)(viii).

Section 1.956-2(d)(1) of the regulations provides that property shall be considered acquired by a foreign corporation when the corporation acquires an adjusted basis in the property.

The taxpayer takes the position that section

956(b)(2)(F) of the Code and section 1.956-2(b)(1)(viii) of the regulations require the test for relatedness, which determines whether the [REDACTED] obligations are U.S. property, to be made when [REDACTED] first acquired an adjusted basis in the obligations before [REDACTED] became a CFC. At that time [REDACTED] was not a related corporation under section 956(b)(2)(F) and therefore the obligations would be excluded from the definition of U.S. property. While we do not agree with the taxpayer's interpretation of section 956(b)(2)(F) and the regulations thereunder, as discussed in our prior memorandum, the taxpayer's argument is in any case irrelevant for tax years of [REDACTED] beginning after [REDACTED], the deemed acquisition date for purposes of the section 338 election.

Section 338(a) provides that if an election under that section is made, the target corporation will be treated as having sold all of its assets at the close of the acquisition date<sup>2</sup> at fair market value in a single transaction, and shall be treated as a new corporation which purchased all of the assets of the old corporation as of the beginning of the day after the acquisition date.

[REDACTED] became a CFC when it was acquired by [REDACTED] on [REDACTED]. As a result of the section 338 election, [REDACTED] acquired a new adjusted basis in all of its assets, including the [REDACTED] obligations, as of the beginning of the day after the acquisition date, [REDACTED]. Accordingly, section 1.956-2(b)(1)(viii) requires the test for relatedness to be made on [REDACTED]. On that date [REDACTED], the U.S. shareholder of [REDACTED] owned more than [REDACTED] of the total combined voting power of [REDACTED]. The [REDACTED] obligations therefore are "U.S. property" for purposes of section 956 for the taxable years of [REDACTED] beginning after [REDACTED].

#### CONCLUSION:

As a result of the section 338 election, [REDACTED] acquired a new adjusted basis in the [REDACTED] obligations on the day after its [REDACTED] deemed acquisition date. At that time, [REDACTED] was a CFC and [REDACTED] was a related corporation under section 1.956-2(b)(1)(viii) of the

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<sup>2</sup> The date selected as the acquisition date under the transitional rules will be the acquisition date for purposes of section 338(a). P.L. 97-248, section 224(d)(5)(A)(i), as amended by section P.L. 97-448.

regulations. Accordingly, the law is clear that as of [REDACTED]  
[REDACTED], these obligations were U.S. property with respect  
to [REDACTED].

If you have any questions about this memorandum, please  
call Valerie Mark at FTS 566-6645.

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